# *Why* Expert Economic Forecasts Are Often Wrong

By Peter J. Wallison and Ryan Nabil

*Analysts ignore the regulatory issue.*

In May 2016, a month before the vote on whether the United Kingdom should leave the European Union, Her Majesty's Treasury told the people of the United Kingdom that "leaving the European Union would tip the UK into a year-long recession, with up to 820,000 jobs lost within two years."

At around the same time, the *Financial Times* polled more than one hundred "leading thinkers" and reported that "almost three-quarters thought leaving the European Union would damage the country's medium-term outlook, nine times more than the 8 percent who thought the country would benefit from leaving." And the Bank of England and the International Monetary Fund both predicted declines or slow growth in key indicators if Brexit was approved.

Yet after the voters in Great Britain ignored these warnings and voted to leave the European Union, the UK economy did not decline as predicted: it began to expand. Table 1 compares the Bank of England's predictions for 2017 with the actual results for key economic indicators.

Something very similar occurred in the United States. Before the election, many financial "experts" who make their living advising others about the direction of the economy predicted that a Trump win would be disastrous for the U.S.—and even the global—economy. Paul Krugman of the *New York Times* predicted a worldwide recession; Simon Johnson, former chief economist for the International Monetary Fund, predicted that a Trump victory "would likely cause the stock market to crash and plunge the world into recession;" Bridgewater Associates foresaw a 2,000 point drop in the Dow; Macroeconomic Advisers predicted an 8 percent fall in U.S. stock prices; and the Brookings Institution projected a 10 percent to 15 percent nosedive.

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On election day in 2016, the Dow closed at 18,330. The next day, when the result was clear, it surged 250 points. Today, eighteen months later, the Dow is well over 24,000.

How can one explain the failure of these experts to foresee that economic conditions in their countries would improve markedly instead of the disastrous declines they were predicting?

There are probably several reasons, including a political bias that blinded them to what others were seeing. But it is also likely that all of them—in Britain as well as the United States—were victims of the same problem: the general failure of economists to understand and assess the costs of regulation to the business communities and the economies of their countries.

Economists on both sides of the Atlantic pay very little attention to the costs of regulation, probably because there aren't any solid sources of data on regulatory costs that can be fed into their economic models. Without this data, these models, used by both government and private economists in the United Kingdom and the United States, could not take account of a vital fact—that both the Brexit vote and Trump's election would actually stimulate economic growth because they would produce a substantial decline over time in government regulation.

*The UK economy did not decline as predicted: it began to expand.*

**Table 1 Bank of England Brexit predictions for 2017 versus actual results for key economic indicators**

| Indicator | 2017 Predicted | 2017 Actual |
|---|---|---|
| GDP Growth | Recession | +1.8 percent |
| Exports | -0.5 percent | +4.4 percent |
| Business Investment | -2.0 percent | +2.6 percent |
| Housing Investment | -4.75 percent | +5.0 percent |
| Employment Growth | 0 percent | +1.0 percent |
| Weekly Wage Growth | -2.0 percent | +3.1 percent |

Sources: Bank of England, *Financial Times,* UK Office of National Statistics.

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It's not as though the politicians didn't try to call these facts to the attention of the experts. Much of the opposition to UK membership in the European Union stemmed from the cost of complying with EU regulations. Boris Johnson, one of the leaders of the Brexit campaign and until recently the British foreign secretary, noted in a speech urging a vote to leave: "We cannot do anything to stop the torrent of EU legislation, coming at a rate of 2,500 a year, and imposing costs of £600m per week on UK business."

Similarly, in the United States, the federal regulations come pouring out of government agencies at a rate of more 3,000 per year, with a total cost to the economy—estimated by Clyde Wayne Crews of the Competitive Enterprise Institute—at $2 trillion. In his campaign, Donald Trump called the Dodd-Frank Act a "disaster" for the U.S. economy and promised to reduce regulations everywhere that were impeding U.S. economic growth. His surprise election signaled to U.S. investors that over time, a reduction in regulatory costs would occur during the incoming Trump administration. This was enough to produce sharp increases in share prices even before Trump actually took office.

Accordingly, if the experts in the United States and United Kingdom are now looking for reasons why their predictions were so embarrassingly wrong, it would be sensible to begin a diligent effort to get better data on regulatory costs and how these costs affect business investment and psychology.

In the United States, the first place to start is the government. It should not be surprising that neither Congress nor the administration in office wants data on the regulatory costs they are imposing on the economy, but these numbers are as vital as monthly employment or sales data if economists and policymakers are to understand the true burdens that government places on businesses and economic growth. ◆